

This article provides an overview of investigative and forensic accounting to facilitate a common understanding

of this area of specialization; further research and discussion; and the identification of opportunities for growth in forensic accounting practices.

### Why forensic accounting?

There has been tremendous growth internationally as well as in South Africa, in the demand for forensic accounting services. The public perception is that forensic accountants only or mainly deal with fraud matters. Indications are that 80% of the income of the forensic practices in the major accounting firms is derived from litigation support in civil dispute issues.

Another misconception is that only large accounting firms provide forensic accounting services. There are numerous smaller firms specializing in some aspect of forensic accounting, be it fraud or civil disputes.

Various reasons are given for this growth in the need for forensic accounting services. These include:

#### The increase in fraud and corruption

Some commentators question whether this is true. They argue that there is now more transparency than in the past, communication is more open and faster and the amounts appear bigger because of inflation. Fact is that there is international concern about the increase in white-collar crime.

#### The globalisation of trade

To accommodate the globalisation of trade, companies are establishing international structures. This has created opportunities for organized crime syndicates to target these multi-national companies and to commit sophisticated crimes across borders. Globalisation has also resulted in increased and more complicated civil disputes.

#### New and complicated legislation

To manage the increase in fraud and to provide support to the globalisation of trade, governments have had to introduce more legislation. This provided the impetus to forensic accountants, who traditionally were involved in investigation and civil disputes, to specialize and expand their services.

#### Litigious environment

With the democratisation of many developing countries and the emphasis on human rights, individuals and organizations are more inclined to revert to litigation to enforce their political and commercial interests. This is already the situation in countries such as the USA and the UK.

#### The growth in the use of, and sophistication of technology used in businesses

The effect of this development has been that:

- Audit trails are not as clear as when manual systems are used.
- Transactions, including fraudulent transactions, are processed with tremendous speed. It is thus easier for fraudsters to reach a greater number of potential victims.
- Errors in accounting and commercial transactions are compounded because of the speed and volume possible through technology. This may lead to more substantial amounts in civil disputes.
- A positive outcome is that technology can be useful as far as the gathering, organizing and structuring of information and evidence are concerned.

### What is forensic accounting?

The literature indicates that there is uncertainty with regard to the designations given to individuals performing forensic accounting services. The terminology being used is expert accountant, forensic accountant, fraud auditor, forensic auditor, fraud investigator or fraud examiner and risk control manager.

The users of forensic services find this confusing. They do not understand what profession these providers of services resort under,

# A growing concern

Danie du Plessis

what standards and ethics apply and what fees can reasonably be charged.

For clarity some definitions are provided:

• **Fraud examination:** A methodology for resolving fraud allegations from inception to disposition. It includes obtaining evidence and taking statements, writing reports, testifying to findings and assisting in the detection and prevention of fraud.

• **Fraud auditing:** A pro-active approach to detecting financial frauds using accounting records and information, analytical relationships and an awareness of fraud perpetration and concealment schemes.

• **Investigative and forensic accounting:** It is the application of financial skills and an investigative mentality to unresolved issues, conducted within the rules of evidence. As a discipline it encompasses financial expertise, fraud knowledge and a strong knowledge and understanding of business reality and the working of the legal system. Its development has been primarily achieved through on-the-job training, as well as experience with investigating agencies and legal counsel.

From the above it would seem that there is a pro-active and a reactive role. What is not clear is what the differences between these individuals or professions are. Is a fraud auditor more highly qualified than a fraud examiner and what is the difference between a fraud examiner and an investigating accountant? The generic term "forensic accountant" is used in this article. There is however a need for standard definitions to be developed by a profession.

Pro-active fraud auditing can be very expensive if it is done on the basis of a fishing expedition, not knowing where to look or going along false tracks. Fraud auditing is more cost effective if the control weaknesses identified in the normal audit processes are used. A fraud risk assessment can also provide information for fraud auditing. Most large organizations have a risk assessment process but the focus is more on business risks.

### What services do forensic accountants provide?

The services provided by forensic accountants are not new to accountants. What is new is that it has become an area of specialization. It is now a multi-disciplinary profession consisting of mainly accountants, lawyers and individuals previously employed by the investigative agencies.

Initially forensic accountants provided financial analysis in the context of legal processes. They also acted as expert witnesses and played a role in mediation and arbitration, either as expert witness or arbitrator. More recently the service has expanded to expert advisor in complicated disputes and providing litigation support consulting. Forensic accountants also act as fraud investigators that can include surveillance and observation. Most of these services are difficult for the ordinary accountants to adjust to. They by nature are non-adversarial and have not received specific training in this regard.

Examples of the services often provided in civil disputes or criminal matters are:

- Acting as expert witness, expert advisor or providing expert determination of facts or quantum of damages.
- Providing a consulting service to attorneys on facts, issues in dispute, general case strategy and cross-examination of opposing experts.
- Providing assistance in the discovery process especially with regard to documents of a financial nature and general business issues.
- Researching background information on the case to pre-determine what the stance of opposing experts is likely to be, or to discredit them in court. This will include research on their previous evidence in court, any articles written or speeches made. The purpose of this will be to identify any contradictions in positions taken over time.

- Computation of damages, actual and future, in cases of civil disputes including those of unfair dismissal.
- Valuations of businesses in instance of disputes such as divorces, dissolution of partnerships, takeovers, and mergers and in completion accounting. Completion accounting is the reconciliation required in mergers or takeovers where warranties and estimated figures have been provided in the contract.
- Document management for large cases that can run into thousands of pages.
- Providing an opinion as to whether Generally Accepted Accounting Principles and Auditing Standards have been complied with in cases of negligence claims against accountants and auditors. There is however a perception that the larger accounting firms are loath to act against one another and would prefer to act in support of each other. A question is whether a forensic accountant who is an expert at investigation, but is not a practicing auditor, can act as expert in negligence cases. The court will ultimately decide on the acceptability of an expert witness.
- Investigating financial statement fraud on behalf of shareholders, creditors or the liquidator of an insolvent estate.
- Tracing of assets on behalf of the stakeholders mentioned above. It can also be in support of Regulators or prosecuting authorities where civil recovery is one of the remedies.
- Analysing the flow of funds in instances of money laundering distinguishing between criminal and legitimate funds.
- Interviewing possible witnesses for information or suspects for confessions.
- Investigating allegations of insider trading in contravention of the applicable legislation.
- Investigating contraventions of legislation regulated by, for example, the Registrar of Banks or the Financial Services Board.
- Investigating specialized matters such as insolvency, insurance, health care or cyber fraud.

### Knowledge and skills of forensic accountants

Forensic accountants have a wide range of knowledge and skills. The following is a general indication:

#### Financial expertise

- A general knowledge of accounting and auditing techniques, principles and standards.
- Understanding the flow of financial transactions in the accounting records.
- Financial analysis techniques such as ratio analysis and business valuations. The results of this can indicate to the forensic accountant that there is a possibility of fraud that has been hidden in the financial statements. In civil disputes these techniques are used to advise the client on the relative strength of his position in possible litigation.
- Although forensic accountants are not usually experts on economic matters and statistics, they should have sufficient understanding of the principles involved to do calculations of losses or damages in civil disputes.
- Cost accounting principles are important in fraud examination as well as in civil disputes. Cost accounting principles may be manipulated to perpetrate financial statement fraud or to favour a certain position in a civil dispute.
- It can be important to reconstruct financial statements to prove income tax or insolvency fraud and to recover assets in fraud or civil proceedings. Criminals usually deliberately destroy books of account and supporting records.

#### Knowledge of the legal framework

- The law of evidence: what is acceptable as audit evidence is not necessarily sufficient for the courts. Forensic accountants gather evidence in criminal and civil matters. They need to preserve the chain of evidence
- The law of contract and delict: the financial implications of and the principles to calculate damages and interest.
- Criminal law: not only the basic criminal law statutes but also the more specialized legislation dealing with the prevention of organized crime, insider trading, money laundering etc.
- Case specific legislation: investigations in terms of the Companies

Act, and legislation applicable to Banks, Insurance Institutions etc.

- Common law: the interpretation of legislation by the courts can establish precedents that need to be followed.
- Other legal aspects: court procedures and issues regarding the discovery of evidence and attorney client privilege.

#### Criminology and soft skills

A number of skills and techniques, for which lawyers and accountants are not trained, are required. Examples are:

- What motivates people to perform, to be loyal and above all what causes otherwise honest individuals to commit fraud.
- The influence of organizational and cultural issues and the environment on human behaviour.
- Economic and social factors influencing the conduct of individuals and the environment in which the organization operates.
- Investigators are expected to be lateral thinkers, team players, have interviewing skills and an investigative mentality.
- They must also have good verbal and writing communication skills and an intuitive feel for irregularities.

#### Acting as expert witness

- The forensic accountant should have clarity on whether he/she is a factual or expert witness. As a general rule witnesses in court may not give an opinion, except where they are required to give expert evidence.
- There should be an understanding of what the requirements are for a court of law to accept a witness as an expert.
- The forensic accountant acting as witness should have good presentation skills and understand the criteria of a report presented for litigation purposes.

#### Practice management

- Practice management is different from the typical accounting and auditing practice where the extent and timing of future work for a client follows in general the same pattern than that of the previous year. The forensic accountant operates in an unstructured environment. The brief for the assignment and the facts on which it is based are not always clear and often develops as the case proceeds. Planning and budgeting is therefore difficult.
- Conflict of interest issues are often difficult to determine. The relationship with the client is usually ad-hoc and it can arise out of an emergency situation. There are often time constraints. Staff appointments and resignations can have a bearing on independence and conflict of interest issues.
- The professional standards for forensic accountants are not clear. To date there has apparently been only one case of professional negligence against forensic accountants on which the facts have been published. Forensic accountants should therefore be aware of the general principles of professional negligence, as this will apply to their practices.
- There are various views as to whether certain documents such as draft reports should be destroyed. If they are destroyed then there should be an audit trail of key decisions made as they are often only recorded in such draft reports.

#### Knowledge of fraud schemes

What distinguishes the forensic accountant from auditors, accountants and other professionals is the fact that he/she has an intimate knowledge of fraud schemes. This includes the methods used by perpetrators to hide their activities. Examples of fraudulent schemes are:

- Owners and senior management: because of their position of trust they can profit from insider trading, not disclose their interest in transactions with the organization or related party transactions.
- Customers: the organization can, through its management, make itself guilty of false advertising, short delivery of orders or providing goods of inferior quality. Customers on the other hand can be guilty of shoplifting, claiming false refunds, using false credit cards, issuing cheques for which there are no funds or provide false information on credit applications.
- Against government: tender or procurement fraud can be perpetrated, false claims can be submitted in terms of subsidy or benefit schemes or there can be tax evasion.

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- Insurance and medical aid: beneficiaries can submit false claims or contrive events that make claims possible.
- Employees and management: they can submit false or inflated expense account claims, claim benefits, commit acts of theft or forgery, accept corrupt payments from suppliers or customers or create ghost employees on the payroll.
- Suppliers of goods and services: short delivery of goods or not in terms of requirements such as price and quality. Double or false invoicing or corrupting employees of the organization.
- Competitors: can falsely obtain trade secrets or other intellectual property or corrupt employees of the organization.
- Investors and creditors: the organization issues fraudulent financial statements or provides other false information such as that in prospectuses.

**Issues in forensic accounting**

Forensic accounting is a relatively new profession. There are therefore a number of issues that have not been clarified, either through research, or the issuing of standards and guidelines. Some of these matters are discussed hereunder:

- One of the issues being debated is the ethics of forensic accountants acting for known or suspected criminals or organized crime syndicates. One view is that it should not be a problem because every person is entitled to a fair trial and it is not the forensic accountant's role to be judgmental, but just to obtain the facts. The solution is to maintain professional distance and not to be socially involved with such a client, which is actually true of all clients. The large forensic accounting firms do, however, seem to have a problem in this regard.
- There is a perception that forensic accounting services are expensive. Forensic accountants usually become involved at the stage when there is a serious or complicated problem that requires the attention of senior staff. If clients do not understand their own requirements and the limitations of what the forensic accountant can achieve, there can be a perception that the benefits of the assignment does not warrant the cost.
- Just as there is an expectation gap between auditors and investors with regard to the auditor's responsibility and capability to detect fraud, the same can apply to services provided by forensic accountants. It is possible that in civil dispute cases the client's view can be that the report of the forensic accountant or the way in which he/she performed in the witness box caused the client to lose the case. The same applies to fraud investigation assignments where the allegations of fraud are vague or where sufficient proof to pursue the matter in court could not be obtained.
- Most forensic accountants make use of financial information only. They are not trained, as investigators are, to obtain evidence from non-financial records such as

diaries or from surveillance and legal telephone tapping.

- Forensic accountants should never work on a contingency fee basis where there is any possibility that they will have to appear in court as a witness. Opposing counsel can totally discredit an expert witness, who is required to be professionally independent, if it transpires that a contingency fee is involved.
- Forensic accounting services are multifaceted and individuals from various professions are involved. The challenge for accounting firms providing forensic accounting services is how to motivate, reward and retain non-accounting skills.
- There is no formal training or certification requirements to practice as a forensic accountant or fraud examiner in South Africa. There are related courses provided at some universities but there is no uniform approach and the qualifications obtained do not lead to any professional recognition.
- Although there should be flexibility in forensic accounting assignments, there must be certain standard methodologies and procedures to guide the work and that are available for practice reviews and in cases of disputes with clients. There is, however, no guidance as to what these standards should be.

Further research needs to be undertaken to address the issues identified above. It can lead to more understanding on the role and responsibilities of the forensic accountant and the differences between it and that of the accountant and auditor.

**Conclusion**

The work of forensic accountants is challenging, varied and rewarding. With the further globalisation of organizations and cooperation of governments internationally, the demand for forensic accounting services should continue to grow.

The following initiatives should however be facilitated to support this growth:

- A process of accreditation of forensic accountants
- The development of standards and codes of ethics and conduct
- Formal education and training programs to encourage new entrants
- CPE opportunities for practitioners **ASA**

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*Danie du Plessis, CA(SA), is the Director, Unit for Forensic Accounting, University of Pretoria*



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